Clerk, Supreme Court, U.S.
FILED
Clerk

IN THE

Supreme Court of the United States

October Term, 1957

No. 602

CITIES SERVICE COMPANY,
Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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I

It was urged in the petition for a writ of certiorari that the decision below should be reviewed by this Court because that decision expands Commission power under Section 11(b)(2) of the Public Utility Holding Company Act of 1935 in a way drastically inconsistent with the intent of Congress, decisions of this Court and decisions of the Commission, both in this case and in other cases. The briefs in opposition* seek to avoid those issues by urging (SEC

*Although it seems unlikely that certain intervening respondents below have any standing in this Court [*cf. Boston Tow Boat Co. v. United States*, 321 U. S. 632], those intervenors nonetheless have filed a brief in opposition.

Br. 10, 12, 15-17; Penn. Br. 5-8*) that the decision below must be correct because the Commission has found, and Cities does not deny, that intra-system business dealings between a parent and its subsidiary can give rise to conflicts of interest in the resolution of which the minority cannot outvote the majority shareholders. That so-called "finding of fact" (SEC Br. 12; Penn. Br. 5-8) is, of course, one that is logically ineluctable in any legal system that envisages subsidiaries that are not wholly owned.** The decision below, which declares such parent-subsidiary arrangements illegal under Section 11(b)(2) of the Act is without precedent and is obviously important. Furthermore, legal issues respecting the interaction of Section 11(b)(2) with Section 11(e) and Sections 12 and 13 of the Act are clearly raised in this case. Resolution of those problems by this Court is obviously important to proper administration of the Public Utility Holding Company Act.

II

The Commission in its opposition (SEC Br. 12-13) contends that Cities is estopped from objecting to the decision below. It urges that Cities is estopped, because had the Company, in 1952,

*References to pages in opposition filed by The Pennroad Corporation, Louis E. Marron, James W. Hearn, et al., will be cited as "Penn. Br. . . . . ."

**Cities has contended before the Commission, the court below and in its petition to this Court that there is nothing in Section 11(b)(2) of the Public Utility Holding Company Act that makes parent-subsidiary relationships and dealings illegal merely because majority-minority interests co-exist in the subsidiary. That contention is the nub of this case. Cities believes that position to be particularly correct where, as here, there is no contention, following examination by an expert commission of "a detailed record of the relationships and dealings between" Cities and Fuel Oil, of any overreaching or spoliation (SEC Br. 10; App. 44a; R. 24a). *Cf. Comstock* v. *Group of Investors*, 335 U. S. 211.

> "... repudiated the jurisdiction reserved in the Commission's order, the Commission surely would not have made the necessary District Court application and the plan would have died a-borning." (SEC Br. 12)

That contention deserves reply, for the facts brutally belie the argument.

The Plan was submitted to the District Court in 1952 under the procedures of Section 11(e) of the Act. Those procedures charge the Commission to

> (1) review each proposed reorganization plan submitted by a registered holding company or subsidiary thereof,
>
> (2) approve such plan as submitted or modified by the submitting company, if the plan is [i] fair and equitable and [ii] necessary to effectuate the provisions of Section 11(b)(2), and
>
> (3) apply to a court (but only "at the request of the company") to enforce and carry out the terms of the plan thus approved.*

The Plan for the reorganization of Arknat [predecessor of Fuel Oil] was submitted to the Commission by Arknat and Cities (App. 52a). The Plan expressly contemplated that with its consummation the new company thereby created, *i.e.*, Fuel Oil, would be in full compliance with Section 11(b). Finally, the application for approval (R. 23b, 24b), which was submitted to the Commission with the Plan, requested that the Commission should apply to a District Court for an appropriate order of enforcement, *but only if the Commission approved the Plan*. That was the request for enforcement upon which the Commission acted.

*For the full text of Section 11(e), see the Appendix to this brief.

In recognition of the fact that the Plan contemplated full compliance with Section 11(b) the Commission ordered hearings that would raise for consideration the following matters and questions:

> "1. Whether the Plan, as submitted or as it may hereafter be modified, is necessary to effectuate the provisions of Section 11(b) of the Act and is fair and equitable to the persons affected thereby.
>
> "2. Whether the Plan achieves the statutory requirements with respect to corporate simplification of the Arkansas-Natural system and with respect to fair and equitable distribution of voting power among the security holders of Arkansas-Natural." (R. 23b)

On October 1, 1952, the Commission issued its findings, opinion and order, approving the Plan (App. 48a-70a). The Commission simultaneously (*i.e.*, on the same day, and before Cities or Arknat had seen any portion of the findings, opinion and order, including the so-called reservation of jurisdiction) submitted the Plan to the District Court for enforcement. To justify that submission, the Commission had to, and did, rely upon the request for enforcement contained in the application for approval which had accompanied the Plan. Throughout the District Court proceedings on the Plan, the Commission never intimated to Cities, to Arknat or to the District Court that Commission approval of the Plan had been anything less than the approval contemplated at the time the Plan was filed and upon which the request to the Commission to apply for court enforcement was predicated. The Commission certainly did not intimate, as it now contends (SEC Br. 8), that it was approving the Plan in part and disapproving it in part.*

*Had the Commission ever so intimated the Plan certainly "would have died a-borning", because consummation of the Plan not only has involved great expense to Cities but has foreclosed to it other methods of compliance, drastically changing Cities' position for the worse.

At no time during the 1950-1952 hearings on the proposed Plan did the Commission or its staff express doubt that the methods proposed therein would effectuate the fair and equitable distribution of voting power required by Section 11(b)(2). Indeed, the findings and opinion of the Commission clearly indicate that in 1952, when approving the Plan, the Commission intended that consummation of the Plan would place the predecessor of Arknat, *i.e.*, Fuel Oil, in full compliance with Section 11(b)(2). It is impossible to read the following language of the findings and opinion and not so conclude:

> "These proceedings involve an amended plan filed pursuant to Section 11(e) of the Public Utility Holding Company Act of 1934 ("the Act") by Arkansas Natural Gas Corporation ("Arknat") and its parent, Cities Service Company ("Cities"), both registered holding companies. The plan, . . . is proposed as a means of complying with Sections 11(b)(1) and 11(b)(2) of the Act. . . .
>
> ". . .
>
> "2. Consummation of the plan is subject to the approval of an appropriate United States District Court, and Arknat and Cities have requested that we apply to an appropriate court to enforce and carry out the plan in the event that it is approved. In accordance with such request, application will be made to an appropriate court following the issuance of our order, and our order will provide that it is not to operate as authorizing or directing the consummation of the plan until such court order enforcing the plan has been entered. (App. 50a, 64a)

As the above-quotation shows, the Commission, of course, was aware that under Section 11(e) it had a right to go to the District Court only if requested by the companies that had submitted the Plan. When the Commission relied for enforcement of the Plan upon the request of Cities

and Arknat, Cities could properly, and did, assume that the reservation of jurisdiction contained in the Commission order approving the Plan did not modify the Plan so as to deprive Arknat (*i.e.*, Fuel Oil) of that full compliance with Section 11(b)(2) which clearly had been contemplated when the Plan was submitted. Unless that were so, the Commission could not legally, under Section 11(e), have submitted the Plan for enforcement, having materially modified the Plan without the consent of its sponsors.

The failure of the Plan to make provision for the elimination of the minority interest was referred to by the Commission only as an objection by a committee representing certain minority stockholders of Arknat (App. 54a, 58a-59a). Had that objection to the Plan been regarded by the Commission as raising questions as to whether the Plan fully remedied the outstanding inequitable distribution of voting power or whether it would be unfair and inequitable to the persons affected thereby, the Commission would have had to decide those questions then and there. To have deferred those answers until after consummation of the Plan would have been to reserve jurisdiction to determine, after the Plan had been consummated, the very questions that had to be determined before the Plan could be approved, *i.e.*, whether the Plan provided an appropriate method for compliance with the provisions of Section 11(b)(2) and whether it was fair and equitable to the persons affected thereby. Unless the distribution of voting power provided by the Plan was determined by the Commission to be fair and equitable, it is clear that the Plan could not have provided an appropriate method of compliance with Section 11(b)(2) nor have been deemed fair and equitable to the persons it affected. Moreover, if it had been marked with those defects which the Commission now suggests, it could not have been approved in 1952 as a plan "necessary" under Section 11(b).

Respondents have refused to meet this argument. They have hinted, to be sure, that this case can somehow be brought within the practice of the Commission which on occasion permits step-by-step compliance with Section 11(b)(2). But this is not such a case. Indeed, there is no case where the Commission ever has used the step-by-step technique to bring a single security (here Arknat common stock) into compliance with Section 11(b). And certainly there is no case in which the Commission ever has tried to use the step-by-step technique to move first one step forward, then one step back. That is not the way of the law, but of the minuet.

Arknat and Cities never sought permission of the Commission to make step-by-step compliance with Section 11(b)(2). The Plan was presented to the Commission as a method of effectuating full compliance. If, as respondents now contend, the distribution of voting power provided by the Plan *per se* effected an inequitable distribution as to the minority stockholders, then in 1952 the Plan must have been unfair and inequitable to those stockholders and must not have provided an appropriate method of effectuating compliance with Section 11(b)(2). Of course, if that had been the case, the statutory findings required by Section 11(e) could not have been made. The proposed Plan would have had to be disapproved, therefore, exactly as was done in *Federal Water Service Corporation*, 18 S.E.C. 231, *affirmed, Securities and Exchange Commission* v. *Chenery Corporation*, 332 U. S. 194.*

*It is erroneous, of course, to suggest, as does the Commission (SEC Br. 12-13), that

> ". . . if the Commission had found in 1952 that the Plan had effected full compliance with Section 11(b)(2), . . . the reservation of jurisdiction and the condition would have had no purpose."

The Commission has power over registered holding companies, *inter alia*, under Sections 3, 5, 12 and 13 of the Act, and in the context of

In this case, however, the Commission approved the Plan; it had the Plan enforced; and now, after enforcement and consummation, it declares that the distribution of voting power provided therein is inequitable to the minority stockholders. That finding squarely contradicts and reverses the earlier Commission conclusion. The most that now can be said for the Commission is that it has had a change of mind. But, as this Court held in *Mine Workers* v. *Eagle-Picher Co.*, 325 U. S. 335, an administrative body has no power to exercise its admittedly wide discretion a second time in disregard of a previous order to which legal sanction has been imparted by court order.

III

Somewhat related to its estoppel argument is the statement of the Commission that not until 1955 did it develop

> ". . . a detailed record of the relationships and dealings between petitioner and Fuel Oil." (SEC Br. 10)

To that there is a short answer. The records in the 1950-1952 and the 1955-1956 proceedings relating to intra-system dealings by Fuel Oil, apart from increments to statistics due to the passage of a few years, are so nearly congruent in terms of the issues raised and explored as to be almost indistinguishable. The Commission in 1952, when it approved the Plan, had facts covering many years of Fuel Oil operation under the so-called hypothetical refinery con-

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the objections raised to the Plan, in 1950-1952, by the stockholders' committee, it was appropriate expressly to retain jurisdiction over Cities and Fuel Oil for the purpose of exercising such powers. That is what the Commission in 1952 conceived itself to be doing. That is what Cities understood the Commission to be doing. That is what this Court should hold the Commission to have done.

tract. The Commission had heard argument from every quarter concerning that arrangement. The Commission now does not contend that any change in the relationships occurred between 1952 and 1956. If, as this Court held in the *Eagle-Picher* case [325 U. S. 335], an administrative agency may not avoid the consequences of its final orders because it subsequently becomes aware for the first time of pertinent facts, it follows, *a fortiori*, that the Commission here cannot avoid the impact of the 1952 order of enforcement by saying that four years thereafter it had collected a more imposing array of facts bearing upon those issues that it had already decided.

CONCLUSION

The decision of the court below is the first which holds that the Commission may enter

> ". . . an order under Section 11(b) mandatorily requiring [the elimination of a minority interest] against the desires of management where the existence of the minority interest and the related business relationships have been the sole basis for action under Section 11(b)." (Reply Brief of Division of Corporate Regulation of the Securities and Exchange Commission, dated December 1, 1955, Dock. No. 31, p. 9)

Equally important is the clear implication in this case that an administrative agency is privileged to enter successive and conflicting orders with respect to the same subject matter.

There is no doubt that the holding will seriously affect administration of the Public Utility Holding Company Act. It may have even greater effect upon administration of the

regulatory process generally. It should be reviewed by this Court.

Respectfully submitted,

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December 27, 1957.

APPENDIX

Section 11(e) of the Act reads:

"In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed."